

Message Text

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ACTION SS-25

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TO SECSTATE WASHDC NIACT IMMEDIATE 5171

C O N F I D E N T I A L SECTION 01 OF 02 LONDON 10006

EXDIS

FOR UNDER SECRETARY COOPER FROM BOYD

E.O. 11652: GDS
TAGS: EAIR, UK
SUBJECT: US-UK CIVAIR NEGOTIATIONS: CAPACITY

1. I UNDERSTAND THE PRESIDENT MAY BELIEVE U.S. SIDE IS COMMITTED TO 65 PCT.LOAD FACTOR IN US-UK CAPACITY ARRANGEMENTS BECAUSE HE MENTIONED THAT FIGURE TO PRIME MINISTER DURING THEIR APRIL 29 TELEPHONE CONVERSATION. MY RECOLLECTION (I WAS IN OVAL OFFICE WHEN CONVERSATION TOOK PLACE) IS THAT PRESIDENT WAS SPEAKING ONLY HYPOTHETICALLY AND THAT HIS INTENTION WAS TO GIVE AN EXAMPLE OF THE KIND OF LOAD FACTOR WHICH AIRLINES MIGHT WANT TO ACHIEVE TO AVOID EXCESS CAPACITY. I URGE THAT PRESIDENT'S REMARK NOT BE REGARDED AS A COMMITMENT BECAUSE INCLUSION OF ANY FIXED, PREDETERMINED LOAD FACTOR IN CAPACITY ARRANGEMENTS WOULD COMPLETELY SUBVERT THE COMPETITIVE ELEMENTS WE ALL AGREE MUST BE MAINTAINED.

2. THE BRITISH CONCEPT IS THAT BOTH GOVERNMENTS AGREE TO ESTABLISH 65 PERCENT LOAD FACTOR AS THE STANDARD WHICH AIRLINES MUST FOLLOW IN ESTABLISHING CAPACITY AND WHICH GOVERNMENTS SHOULD USE TO DETERMINE CAPACITY IN THE EVENT OF DISPUTE. THIS MEANS THAT CAPACITY
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BECOMES AUTOMATICALLY DETERMINED BASED ON A STANDARD SEAT FACTOR AND FORECASTS OF MARKET GROWTH, REGARDLESS OF ANY OTHER CONSIDERATIONS. THIS OUTCOME WOULD, OF COURSE, COMPLETELY DISREGARD COMPETITIVE ELEMENTS. IT WOULD, MOREOVER, PERMIT THE BRITISH TO ACHIEVE A 50-50 CAPACITY SHARE BECAUSE OUR AIRLINES ARE ABLE TO OPERATE VIABLY AT LOAD FACTORS BELOW THOSE OF BRITISH

AIRWAYS.

3. BRITISH THEMSELVES ADMIT THAT EVEN BRITISH AIRWAYS COULD NOT OPERATE THIS WINTER AT ANYWHERE NEAR A 65 PERCENT LOAD FACTOR AND STILL PROVIDE TOLERABLE LEVELS OF SERVICE TO PUBLIC. (SEE PARA 5 BELOW.) I HAVE NO DOUBT, THEREFORE, THAT THE BRITISH ARE WILLING TO NEGOTIATE A LOWER FIGURE, BUT WE MUST NOT BE DRAWN INTO SUCH NEGOTIATION BECAUSE A FIXED LOAD FACTOR WOULD BE DISASTROUS REGARDLESS OF ITS LEVEL.

4. FOLLOWING ECONOMIC ANALYSIS SHOWS WHY BRITISH APPROACH IS NOT ECONOMICALLY VALID AND WOULD IMPACT DISPROPORTIONATELY ON OUR AIRLINES. THIS ANALYSIS SHOULD NOT BE VIEWED AS JUSTIFYING A LOAD FACTOR LESS THAN 65 PERCENT OR DIFFERENTIATED LOAD FACTORS GEARED TO SEASONS, TYPE OF MARKET, OR OTHER VARIABLES.

A. SEAT FACTORS OF THE ORDER OF 65 PERCENT ANNUAL AVERAGE ARE VERY HIGH FOR SCHEDULED AIR SERVICE IN MARKETS SUCH AS NORTH ATLANTIC. LARGE SEASONAL SWINGS AND DIRECTIONAL NATURE OF TRAFFIC FLOWS IN THIS MARKET REQUIRE ANNUAL AVERAGE SEAT FACTORS OF THE ORDER OF 55-60 PERCENT TO MEET TRAFFIC DEMANDS (I.E., TO PROVIDE ACCEPTABLE PROBABILITY OF SPACE BEING AVAILABLE A REASONABLE TIME BEFORE DEPARTURE).

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B. GIVEN A SEASONAL DISTRIBUTION OF TRAFFIC OF ABOUT 70 PERCENT SUMMER (APRIL-OCTOBER) AND 30 PERCENT WINTER (NOVEMBER-MARCH), A DAILY YEAR-ROUND SERVICE WHICH OPERATED AT AN ANNUAL AVERAGE OF 58 PERCENT SEAT FACTOR

WOULD ACHIEVE A 70 PERCENT SEAT FACTOR IN SUMMER AND A 41 PERCENT SEAT FACTOR IN WINTER.

C. THE STATED AIM OF UK IS TO TAILOR CAPACITY TO MARKET DEMAND AS CLOSELY AS POSSIBLE. ONE OBVIOUS WAY FOR UK TO DO THIS IS TO REDUCE WINTER CAPACITY TO PRODUCE HIGHER WINTER SEAT FACTORS. FOR EXAMPLE, A DAILY SERVICE OPERATING AT AN AVERAGE WINTER SEAT FACTOR OF 41 PERCENT MIGHT BE REDUCED TO 4 ROUND TRIPS PER WEEK, RAISING AVERAGE SEAT FACTOR TO NEARLY 72 PERCENT (ASSUMING NO LOSS OF TRAFFIC AT THIS LOWER SERVICE LEVEL). THIS IS, IN THEORY, FINE. THE PUBLIC SUFFERS FROM A LESSER LEVEL OF SEAT AVAILABILITY AND FLIGHT CHOICE, BUT SEAT FACTOR HAS BEEN INCREASED TO AN ANNUAL AVERAGE OF OVER 70 PERCENT.

D. PROBLEM IS THAT TRANSATLANTIC AIRCRAFT SUCH AS B-747 COVERS ALL OUT OF POCKET COSTS AT A SEAT FACTOR OF 35-40 PERCENT, GIVEN PRESENT FARE YIELDS IN A MARKET SUCH AS NEW YORK-LONDON. THUS A CARRIER, GIVEN NO SUPERIOR ALTERNATIVE USES FOR THE AIRCRAFT, IS BETTER OFF OPERATING IT AT AN AVERAGE OF, SAY, 41 PERCENT SEAT FACTOR THAN HE WOULD BE IF HE GROUNDED
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THE AIRCRAFT. MOST CARRIERS DO NOT HAVE ALTERNATIVE USES FOR THEIR AIRCRAFT IN THE WINTER SEASON.

E. THE UK WOULD PROPOSE TO REQUIRE A CARRIER TO GROUND THE AIRCRAFT IN THE WINTER FOR AT LEAST SEVERAL DAYS PER WEEK, OR TO USE IT IN A NON-CAPACITY-CONTROLLED MARKET. THE MEANS FOR ENFORCING THIS IS THE CAPACITY ARRANGEMENTS; THE END THAT IS CLAIMED TO JUSTIFY THIS IS IMPROVEMENT OF ENERGY USAGE EFFICIENCY AND REDUCTION IN WASTE OF RESOURCES.

F. US COUNTERPROPOSAL HAS BEEN TO RELY MORE ON RATE-MAKING PROCESS, AND ECONOMIC COST OF RESOURCES SUCH AS FUEL. IF RATES ARE CONTROLLED SO THAT CASH BREAK-EVEN LOAD FACTOR IS 45-50 PERCENT, THEN CARRIERS WILL HAVE THE INCENTIVE TO OPERATE ONLY AT LOAD FACTORS THAT EXCEED THIS BREAK-EVEN. IF FUEL COST IS HIGH, THEN CARRIERS WILL HAVE EVERY INCENTIVE NOT TO WASTE FUEL.

G. DIRECT CONTROL OF CAPACITY, IN OUR VIEW, NOT ONLY DISCOURAGES MANAGEMENT INITIATIVE IN ALLOCATING RESOURCES AS EFFECTIVELY AS POSSIBLE, BUT ALSO LEADS TO UNNATURALLY HIGH SEAT FACTORS AND DEGRADED STANDARDS OF PUBLIC SERVICE.

5. UK DOES NOT BELIEVE HIGH WINTER LOAD FACTORS ARE POSSIBLE WITH TOLERABLE SERVICE LEVELS. LAST FRIDAY, UKDEL ADVANCED FOLLOWING FREQUENCY FOR EACH OF TWO

AIRLINES (EXCEPT AS NOTED) AND MARKET LOAD FACTORS

ESTIMATES TO/FROM LONDON FOR WINTER 77-78.

A. MIAMI - 7 FREQ, 43 PERCENT

B. CHICAGO - 5 FREQ, 40 PERCENT

OR - 4 FREQ, 50 PERCENT

C. LA - 7 FREQ, 55 PERCENT

D. PHIL-BOS - 5 FREQ, 45 PERCENT (FOR EACH OF
THREE AIRLINES)

E. NY - 14 FREQ, 55 PERCENT (FOR EACH OF THREE

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AIRLINES)

F. DET/WASH - 4 FREQ, 57 PERCENT

G. IN OTHER WORDS, IN ORDER ACHIEVE A 65 PERCENT LOAD
FACTOR, AIRLINES WOULD HAVE TO REDUCE FREQUENCIES AND
SERVICE TO PUBLIC DRASTICALLY.

6. IN ADDITION TO FOREGOING, WHICH APPLIES PARTICULARLY
TO US-UK AGREEMENT, INCLUSION OF SPECIFIC SEAT FACTOR
STANDARD, AT ANY LEVEL' WOULD HAVE MOST SERIOUS ADVERSE
CONSEQUENCES:

A. EVEN IF SET AT 50 PERCENT, PRINCIPLE WOULD BE ESTA-
BLISHED, AND US MIGHT BE PUSHED IN SUBSEQUENT NEGOTIA-
TIONS TO RAISE LEVEL TO 55, 60, 65 PERCENT IN THE
FUTURE.

B. OTHER GOVERNMENTS (JAPAN, FRANCE, ITALY, ETC.)
WOULD LIKELY OUSH FOR SIMILAR STANDARD AND USE THIS AS
MECHANISM TO REDUCE COMPETITIVENESS OF US AIRLINES
WORLDWIDE.

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